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J K Cement Ltd. (JKCEME)

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JK Cement is a play on the booming cement market in the northern region. The company's aggressive expansion-cum-cost-cutting plans coupled with low valuations (enterprise value per tonne of \$72) make the stock a good medium to long-term investment.

Company Background

JK Cement was formed following the de-merger of JK Synthetics in November 2004. JK Synthetics was involved in manufacturing man-made fibres and cement. However, it incurred heavy losses and its net worth was eroded. Subsequently, it de-merged its cement division into a new company, JK Cement.

The company is one of the leading grey cement manufacturers in northern region. It has plants at two locations in Rajasthan — Nimbahera with three kilns and 2.8 million tonnes per annum (mtpa) capacity, and Mangrol with a capacity of 0.75 mtpa. Recently, the company expanded its grey cement capacity by 0.5 mtpa, increasing its installed capacity for grey cement to 4.05 mtpa.

JK Cement is also the second largest white cement manufacturer in the country with an installed capacity of 0.3 mtpa. Recently, it expanded white cement capacity by 0.5 lack tpa. All its plants are located close to its mining reserves. Mining reserves are estimated to have a lifespan of 40 years. The company has a strong dedicated marketing network.

Investment Rationale

Emerging as a focused cement player JK Cement acquired the cement business of JK Synthetics following the de-merger. It took over the grey cement plants at Nimbahera and Mangrol, captive power plant at Bamania and white cement plant at Gotan 'as a going concern' in November 2004.

The company recorded a profit before tax of Rs 52.21 crore on a turnover of Rs 1108.68 crore in FY06 resulting EPS at Rs 6.37. Its net worth as on March 31, 2006, was Rs 354.0 crore compared to Rs 54.59 crore as at March 31, 2005. Capacity utilisation stands at 98.9%.

Captive power plant to boost earnings

Power is a key cost component for cement plants. JK Cement has addressed this key issue by setting up its own captive power unit. Currently, the company pays Rs 4.70 per unit of power. It sources its requirement from the Rajasthan State Electricity Board and a small part from captive diesel generating sets. After the captive power plants are commissioned, we expect cost of generation to come down to Rs 2 per unit. So assuming the company uses the current 88 units of power consumption per tonne, we expect savings of approximately Rs 240 a tonne, which will be reflected during FY08. This plant will meet the company's entire power requirement and will help it reduce power costs. Savings from the captive power plant are expected to be around Rs 76 crore from FY08E onwards.

Aggressive expansion plans to double capacity by 2009

The company plans to set up a green-field plant of 2.5-3 million tonnes in northern Karnataka. The project will be funded through debt and internal accruals in a 50:50 ratio. There are not many cement plants in the region and the company will be able to cater to Karnataka, Goa and parts of Maharashtra. The location will also shield it from region-specific downturns apart from giving it a presence in the southern region. It will also enhance the company's stature from a regional player to a national player.

De-risked business model

JK Cement's white cement business accounts for almost 17% of total revenue at Rs 159.84 crore. There are only three manufacturers of white cement in India. JK White and Grasim White have a national presence, while Travancore Cement is restricted to Kerala and Tamil Nadu. White cement fetches higher realisations (sells at 2½ times that of grey cement). It is not a cyclical business and a steady revenue contributor. White cement sales are primarily in the domestic market. The company also exports to South Africa, Nigeria, Singapore, Bahrain, Bangladesh, Sri Lanka, Kenya, Tanzania, UAE and Nepal.

Cement/clinker production to improve

The company's cement/clinker conversion ratio is 1.14, which is below the industry average of 1.30. The company is targeting 75-80% of blended cement and overall ratio about 1.22. This was reflected during latest Jan-Mar 2006 where the proportion of blended cement increased to 60% against the average of 30% in the last quarter. We expect availability of blended material to increase in the northern region on account of capacity expansions planned by the steel and power sector going forward.

Proximity and access to large limestone reserves

JK Cement has access to large reserves of limestone for producing both grey and white cement. Based on independent geological surveys of different mines during 1996 to 2001, the limestone reserves are sufficient to support its current and planned capacity for approximately 40 years. Further, the manufacturing plants are located close to the limestone reserves, resulting in lower transportation costs. The mines that supply the white cement plant at Gotan also have white clay, an important additive necessary for white cement production.

Quality products and strong brand name

The company has built a strong reputation by consistently providing high quality products. There is strong customer awareness of the company's brands, JK Cement (Sarvashaktiman) for grey cement in its principal market in northern India, and JK White (Camel) for white cement across India. Its brand name and reputation provides the company with a competitive advantage in ensuring that cement dealers carry products.

Risks & Concerns

Inflationary pet coke prices

JK Cement has plans to run its plant on 90% pet coke. Any change in pet coke price will impact profitability.

Change in government policy

Cement is a low-value, bulky commodity. Transportation costs account for a significant expenditure to the industry. Further, most transportation regulations (like roads and railways) are governed by government policies. Any increase in cost resulting from change in government policy may have adverse effect on the profitability of the company.

since no matching quarter data is found, so no quarter comparison has been shown
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Key Financial Ratios					
	2005/03	2004/03	2003/03	2002/03	2001/03
EPS	1.26	0.01	-0.05	-14.29	-11.43
CEPS	3.78	0.01	-0.05	-14.29	-11.43
Book Value	50.90	11.27			
Dividend/Share	0.00	0.00	0.00	0.00	0.00
OPM	10.82	-5,100.00	0.00	0.00	0.00
RONW	8.89	0.08	0.00	0.00	0.00
Debt/Equity	9.85	1.29	0.00	0.00	0.00
Ratio	1.10	333.68	0.77	0.58	0.70
Interest Cover	1.90	1.08	0.00	0.00	0.00

Financials:

Sales to show healthy growth

JK Cement is set to witness strong growth in turnover on account of additional production due to enhancement in grey and white cement capacity. Higher blended cement, firm trend in cement prices in the northern region and the cyclical upturn in the northern and central regions will also boost sales. We expect company's net sales to grow from Rs 883.08 crore in FY06 to Rs 1157.83 crore in FY07E, and further to Rs 1406.25 crore in FY08E at a CAGR of 26.37%.

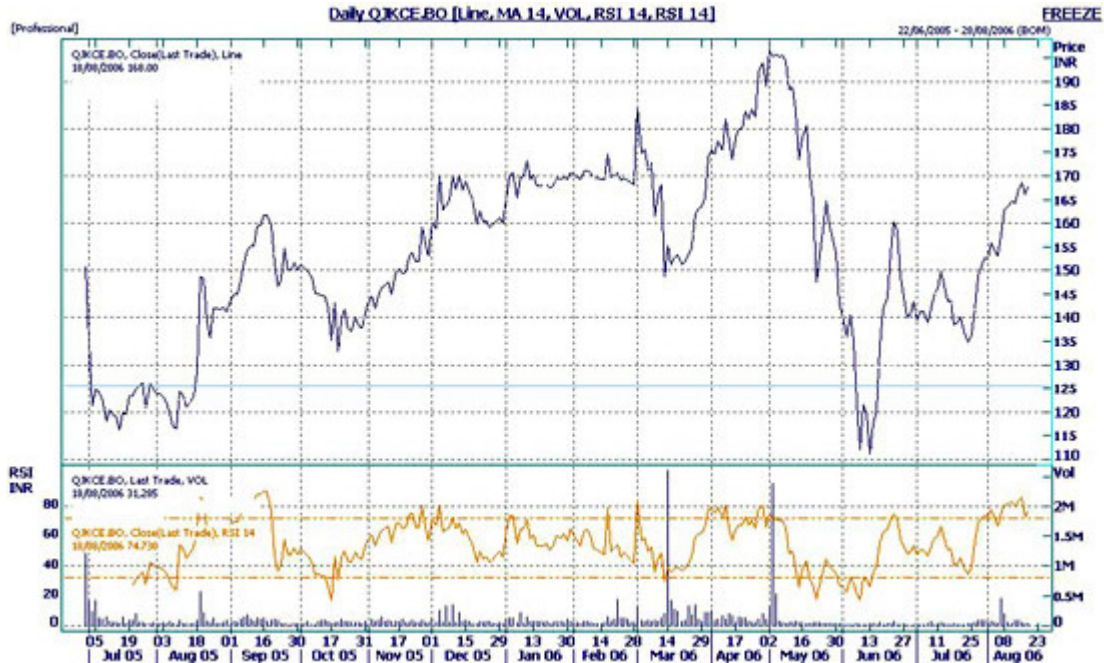
Operating margins to improve

- We expect JK Cement's operating profit margin to improve from 16.01% in FY06 to 23.39% in FY08E. Operating profits should to increase from Rs 132.02 crore in FY06 to Rs 318.18 crore in FY08E.
- The benefits of working capital facilities sanctioned (Rs 65 crore) in Dec 2005 and the commissioning of a 10-MW turbine power plant in Dec 2006 will help improve margins.
- Reduced cost due to captive power plant and improved price realisations will help the company improve operating margin level despite increase in power and fuel cost.
- The captive power plant will add a significant cost saving over the units using grid power. Cost savings for the plant per unit are estimated to be Rs 2.70 per kW.

Net profit to post a CAGR of 215% during FY06-08E

We expect JK Cement to post a net profit of Rs.151.83 crore in FY08E from Rs 32.56 crore in FY06 at a CAGR of 215% on the basis of improved realization, capacity additions and cost savings.

technical analysis



Valuation

On EV/tonne basis, JK Cement is quoting at \$72 per tonne, which is lowest compared to the deals that have happened recently (\$150-\$200 per tonne). The stock currently quotes at 4.98x EV/EBITDA of FY08E. On a P/E basis, the stock is trading at 16.87x FY07E and 7.6x FY08E. We have valued JK Cement by applying the P/E multiple, which yields a value of Rs 293 per share at an industry average P/E of 13.5x FY08E EPS.